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Supreme Court, U. S.
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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1935.

No. 273

COMMONWEALTH TRUST COMPANY OF PITTSBURGH, TRUSTEE, AND THOMAS B. MACMILLAN, JOHN L. BRENTZELL, JANE B. WHEELER AND ANNA L. MEYER,

Petitioners,

vs.

ARTHUR R. ATWOOD, RECEIVER OF THE BANK OF PITTSBURGH NATIONAL ASSOCIATION, IN LIEU OF C. O. THOMAS, RECEIVER AT THE TIME SUIT WAS BROUGHT.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

WILLIAM A. WILSON,
W. DENNING STEWART,
Solicitors for Petitioners.

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PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petition of Commonwealth Trust Company of Pittsburgh, trustee, and Thomas B. MacMillan, John L. Brentzell, Jane B. Wheeler and Anna L. Myer respectfully shows:

A. Summary Statement of the Matter Involved.

(a) *The Decrees Below.*

Your petitioners are Commonwealth Trust Company of Pittsburgh, trustee, appointed by and subject to the Orphans' Court of Allegheny County, Pennsylvania, and four

of a large number of holders of participation certificates in a mortgage pool, formerly operated by a national bank, now in the hands of a receiver, appointed by the Comptroller of the Currency pursuant to the National Bank Act. Your petitioners seek to have this Court review a final decree in equity of the United States Circuit Court of Appeals for the Third Circuit entered on May 2, 1935, which decree affirmed with modifications, a decree of the District Court of the United States for the Western District of Pennsylvania. The decision of the Circuit Court of Appeals was by a divided court.

The proceeding in the District Court was a Bill in Equity filed by the receiver of The Bank of Pittsburgh National Association (hereinafter referred to as Bank), against Commonwealth Trust Company of Pittsburgh, trustee, and four of the beneficiaries of a general trust fund of mortgages, commonly called a mortgage pool. The bill was filed after the Orphans' Court, with the consent of the receiver of the Bank, had acquired custody of the mortgage pool trust res, and had appointed the Commonwealth Trust Company of Pittsburgh as successor trustee to the insolvent Bank. The plaintiff prayed for an injunction restraining Commonwealth Trust Company of Pittsburgh, trustee, from making payments of either principal or interest out of the mortgage pool unless and until the rights of the Bank to participate in the pool were determined by the United States Court; an adjudication of the right of the Bank to payment of the amounts claimed by it out of the mortgage pool; an accounting from the Commonwealth Trust Company of Pittsburgh, trustee, and for general relief.

The facts of the case were submitted to the trial court on stipulation. The amounts of the alleged claims of the Bank were not disputed.

The principal defenses were (1) that the District Court was without jurisdiction to adjudicate the claims of the Bank against the trust res in the custody of defendant trustee, an officer of the Orphans' Court of Allegheny County, Pennsylvania. (2) That on grounds of comity, the District Court should have declined jurisdiction; and (3) the claims of the Bank were subordinate to the claims of its *cestui que trustent*, the holders of certificates of participation in the mortgage.

The District Court sustained its own jurisdiction, adjudicated the amounts of the claims of the plaintiff Bank and ordered payment by the Commonwealth Trust Company of Pittsburgh, trustee, of one claim forthwith. The court further determined that the Bank was a participant with other *cestui que trustent* in its own mortgage pool and a creditor thereof and was entitled to priority of payment upon distribution by the Orphans' Court. The District Court retained jurisdiction to enforce any further orders it might make in the proceedings.

The Circuit Court of Appeals by a divided Court, affirmed, but modified the decree of the District Court, by striking out the order to the Commonwealth Trust Company of Pittsburgh, trustee, to pay any of the claims forthwith. The court, however, held the District Court had jurisdiction, not only to establish the existence and amounts of the claims of the Bank but to determine that it was a *cestui que* trust and to establish the status of the alleged claims against the trust res in the custody of the Orphans' Court of Allegheny County. A petition for reargument was denied without opinion.

(b) *Statement of Facts.*

The Bank of Pittsburgh National Association, a national bank was duly authorized by the Federal Reserve Board on October 14, 1919, to exercise trust powers pursuant to

the provisions of Section 11 (k) of the Federal Reserve Act, 38 Stat. 251 ch. 6 (12 U. S. C. A. 248). The Bank was the original mortgagee in and held title in its own name, to numerous mortgages, aggregating, when the Bank closed, the sum of $5,347,585.57. The Bank was also trustee for numerous trusts. The Bank issued and sold to itself as trustee of the various trust estates for which it was trustee, certificates (R. 26-27) reciting that its various trust estates were entitled to participate in a pool of mortgages created by the Bank to the extent of the investment of the individual trust estate therein. The mortgages were held in trust by the trust department of the Bank.. There were over four hundred trust participants in the pool. At the time the Bank closed it had invested, for its various trust estates, in its mortgage pool, a total of $5,056,565.12 leaving the sum of $291,020.45 (R. 28), which sum represented the unsold portion of the pool.

The trust department of the Bank collected the interest on the mortgages and paid the participants therein, as well as the Bank, at the rate of 6% *per annum*, less trustee's (the Bank) commission and taxes. On August 15, 1931, the interest collections from the pool being insufficient therefor the Bank advanced the sum of $57,156.76 with which to pay the delinquency in interest due the participants. Between August 15, 1931, and September 21, 1931, the date it closed, the Bank repaid to itself all but $40,213.58 of the interest advanced (R. 29).

On September 15, 1931, Respondent's predecessor was appointed receiver of The Bank of Pittsburgh National Association by the Comptroller of the Currency. On January 30, 1934, present Respondent was appointed.

On January 19, 1932, on petition of a *cestui que* trust of the Bank, one of the participants in the mortgage pool, which petition was joined in and consented to, by the Bank's receiver, Respondent's predecessor, the Orphans' Court of

Allegheny County, Pennsylvania, took jurisdiction over and the custody of the mortgage pool of the Bank and appointed Commonwealth Trust Company of Pittsburgh, one of the petitioners herein, as successor trustee to Bank of Pittsburgh National Association. The mortgages in the pool, the accompanying bonds and cash on hand, were, pursuant to the orders of the Orphans' Court of Allegheny County, Pennsylvania, surrendered and assigned by the Bank's receiver (Respondent's predecessor) to the trustee of the Orphans' Court, petitioner herein (R. 29-30). There was neither averment nor proof by Respondent that there had been an accounting in the Orphans' Court of said mortgage pool trust estate by either the Bank as trustee, or by its successor trustee, petitioner herein, although an accounting is required of both, by the laws of the Commonwealth of Pennsylvania.

Pursuant to orders of the Orphans' Court of Allegheny County, Pennsylvania, payments of principal and interest have been made by its trustee from time to time, from the mortgage pool to the participants therein, but not to the Bank, the Orphans' Court having ordered that no payments be made to the Bank, pending a judicial determination of the rights of the Respondent receiver to share in the distribution from the Bank's mortgage pool (R. 31-33).

B. Reasons Relied On for Allowance of Writ of Certiorari.

(a) Petitioners respectfully submit that the question here involved is one of paramount public importance, as it involves an inevitable conflict between the powers of a Federal Court and the powers of a sovereign State exercised through one of its Courts of Record, acting by the officer of that court, one of the petitioners herein. It is respectfully submitted, that if upon final distribution, the Orphans' Court of Allegheny County, Pennsylvania, concludes that the Bank is not entitled to share in the fund in the custody

of that Court, a Federal Court, on principles of comity, if not on jurisdictional grounds should not undertake to preclude said Orphans' Court from consideration of any question involved in the distribution of said trust fund, by its opinion and judgment herein. This is particularly true in view of Respondent's predecessor having submitted himself and the assets of the Bank's trust estate to the jurisdiction of said Orphans' Court.

(b) The majority opinion, of the learned Circuit Court of Appeals, entirely ignores the legal significance of the fact that the Bank was not only trustee of the mortgage pool, but it was as well trustee of various trust estates to which it sold interests, in its own mortgage pool. It is beyond question that the Respondent is obliged to file an account in the Orphans' Court of Allegheny County, Pennsylvania, of its management and conduct of its various trust estates, including the mortgage pool trust. Notwithstanding, one of the petitioners herein has been appointed as successor trustee to the Bank, nevertheless, the latter is still obliged to file its account with the Orphans' Court of Allegheny County, Pennsylvania, and until that accounting is had, the Respondent is not entitled to assert claims against the trust estate, formerly in its hands as trustee. Upon that accounting numerous questions are inherent in the situation and will undoubtedly arise. The interest of Respondent (the Bank) in the pool will necessarily depend upon the determination of such questions as whether the Respondent trustee had the right to invest funds of its trust estates in its own mortgages, whether the Respondent Bank had properly managed the pool, whether it has made illegal investments, and questions of similar import. It is obvious that the pool is insolvent in an equity sense. These questions, it is submitted, are for the sole determination of the Orphans' Court of Allegheny County, Pennsylvania.

(c) Petitioners respectfully submit that the majority opinion in the case at bar conflicts in principle with the decisions of this Honorable Court in the cases of *Commonwealth of Pennsylvania* v. *Williams,* 293 U. S. —, 55 S. C. R. 380, and *Casualty Company* v. *Commonwealth of Pennsylvania,* 293 U. S. —, 55 S. C. R. 386.

(d) Petitioners respectfully submit that the opinion of the majority herein is in conflict with the opinion of the Circuit Court of Appeals for the First Circuit in *Peoples Trust Co.* v. *United States,* 23 F. (2nd) 381).

(e) Petitioners respectfully submit that insofar as the majority opinion holds that Respondent is entitled to claim payment of the sum of Forty-thousand two hundred thirteen dollars and fifty-eight cents ($40,213.58), being interest advanced by appellee to participants in the mortgage pool, said holding is in conflict with the holding of the Circuit Court of Appeals for the Eighth Circuit in *Trust Company* v. *Ricketts,* 75 F. (2nd) 309.

(f) Petitioners respectfully submit that the majority opinion of the Circuit Court of Appeals entirely overlooks the legal significance of the admitted fact that the Bank sold or issued participating interests in mortgages it owned to its *cestuis que trustent,* and mingled its funds with those of the trust estates for which it was trustee, in violation of the provisions of the Federal Reserve Act, Section 11 (k) (12 U. S. C. A. 248), requiring national banks "to segregate all the assets held in any fiduciary capacity from the general assets of the Bank" and in violation of Section VII of Regulation F of the Federal Reserve Board which requires that "Securities and investments held in each trust shall be kept separate and distinct from the securities owned by the Bank and separate and distinct from one another", as well as the well settled principle of general law that under such circumstances, the *cestuis que trustent*

are entitled to be paid out of the trust fund in preference to the claims of their trustee, which principles of law have beeen followed by the Federal Reserve Board in its ruling that a mortgage pool, such as was created by the Bank, was illegal.

(g) Petitioners respectfully represent that the majority opinion forecloses the rights of numerous *cestuis que trust-ent* as against Respondent, whose trust estates are entirely independent of each other and of Respondent. They are entitled to their day in Court and have not had an opportunity to be heard and are indispensable parties hereto.

WHEREFORE, your petitioners respectfully pray that this Honorable Court issue a Writ of Certiorari, directed to the Circuit Court of Appeals for the Third Circuit and requiring said Court to certify the record in the above entitled case to this Honorable Court, to the end that the judgment of said Circuit Court of Appeals may be reviewed and reversed.

And your petitioners will ever pray.

COMMONWEALTH TRUST COMPANY OF PITTSBURGH,
Trustee,
THOMAS B. MACMILLAN,
JOHN L. BRENTZELL,
JANE B. WHEELER,
ANNA L. MEYER,
Petitioners,
By WILLIAM A. WILSON,
W. DENNING STEWART,
Solicitors for Petitioners.

BRIEF IN SUPPORT OF PETITION.

Opinions of Courts Below.

The opinion of the District Court will be found at Record (pp. 15-19 and 35-40). The opinion of the Circuit Court of Appeals will be found at (R. 53). Neither opinion has been officially reported.

Jurisdiction.

The jurisdiction of this Court is rested on Section 240 of the Judicial Code, as amended by the Act of February 13, 1925, Sec. 1, 43 Statutes 938, Section 347, Title 28, U. S. C. A. page 359.

The date of the decree of the United States Circuit Court of Appeals for the Third Circuit, to be reviewed, is May 2, 1935.

Grounds Upon Which the Jurisdiction of this Court Is Invoked.

The grounds upon which the jurisdiction of this Court is invoked appear at pp. 5 to 8 of the petition.

Statement of the Case.

The case is fully stated in the petition, at pp. 3 to 5.

Specifications of Error.

1. The learned Circuit Court of Appeals erred in holding that the District Court had jurisdiction of the cause of action.

2. The learned Circuit Court of Appeals erred in failing to hold that the cause in the District Court should have been dismissed on grounds of comity.

3. The learned Circuit Court of Appeals erred in holding that Respondent had a claim against the assets of the trust res in the custody of the trustee of the Orphans' Court of Allegheny County, Pennsylvania.

4. The learned Circuit Court of Appeals erred in failing to hold that the proceeding in the District Court was defective for want of indispensable parties.

ARGUMENT.

I.

The District Court Was Without Jurisdiction of the Subject Matter.

A District Court of the United States has original jurisdiction "of all suits of a civil nature, at common law or in equity, brought by the United States, or by any officer thereof authorized by law to sue • • • ." Judicial Code 41 (1), Title 28, U. S. C. A., page 37.

The proceeding in the District Court was a bill in equity filed by the Receiver of a National Bank and hence was one filed by an officer of the United States but it is submitted that as plaintiff's bill showed on its face that plaintiff was attempting to enforce a claim against its own trust estate in advance of an accounting by it to the Orphans' Court of Allegheny County to which court an accounting was due from it under the laws of the Commonwealth of Pennsylvania, the plaintiff was without a cause of action and hence a "suit" did not lie in equity. In other words, until the Bank accounted as Trustee for its handling of the trust estate, it was a legal impossibility to determine what claim it had against petitioners herein. That accounting could only be made in the Orphans' Court of Allegheny County, to which Court the Bank had submitted itself, in asking

leave to resign and in procuring an order to turn over the trust res to a successor trustee (R. 29-30), one of the petitioners herein. The respondent's predecessor acted in pursuance of Regulation F of The Federal Reserve Board which provides:

> "Whenever a national bank exercising fiduciary powers becomes insolvent and a receiver is appointed therefor by the Comptroller of the Currency, such receiver will, pursuant to the instructions of the Comptroller of the Currency and to the orders of the court or courts of appropriate jurisdiction, proceed to close such trusts and estates as can be closed promptly and transfer to substitute fiduciaries all trusts and estates which can not be closed promptly."

Plaintiff below (R. 10-11) sought by its bill, injunctive relief and an accounting, from the Commonwealth Trust Company of Pittsburgh, one of the petitioners, a Trustee appointed by the Orphans' Court of Allegheny County, Pennsylvania and its officer. Had the proceeding been merely for the determination of the amount of plaintiff's claim, the action would have been at law—*Scott* vs. *Neely*, 140 U. S. 106, 110, but plaintiff's bill being for equitable relief by injunction and accounting, it obviously presented a basis for equitable jurisdiction.

The proceeding below was instituted after the State Court took possession of the trust res by its officer, respondent Trustee. Had the Orphans' Court the power to appoint a receiver it would have undoubtedly done so, under the facts, in the case at bar, but not having such power it appointed an officer with substantially the same duties, namely a Trustee. The court is authorized so to do by the Act of Assembly of Pennsylvania of July 7, 1917, Section 53 (c), 20 Purdon Par. 931. In this situation the language of this learned Court in *Riehle* vs. *Margolies*, 279 U. S. 218 at

225 becomes of significance in the case at bar. There this Court said:

> "It would hardly be doubted that a final judgment, recovered in a state court prior to the commencement of the receivership suit, would establish conclusively the existence and amount of the claim against the debtor, if later a decree were entered in the federal court distributing the funds in the receiver's hands among its creditors. Wether such a judgment recovered in a suit commenced after the appointment of the receiver would operate as res judicata we need not consider."

If the decree in the case at bar is *res judicata,* then the liquidation of the mortgage pool and the plan of distribution thereof by the Orphans' Court which has possession of it, has been, in part at least, interfered with by the decree of the Federal Court, which as we read *Riehle* vs. *Margolies, supra,* at page 222, is contrary to all decided cases. The Circuit Court of Appeals held (R. 60):

> "* * * we hold, with the learned trial Court that it (the item of advance payment of $40,213.58) constitutes a valid debt of the trust and should be repaid the bank before further distributions are made to certificate holders."

Whether this is proper, is, surely a matter for the determination of the court having possession of the trust res, the Orphans' Court of Allegheny County, Pennsylvania. If all that were involved here, was the determination of the amounts of respondent's claims, *Riehle* vs. *Margolies, supra,* might be controlling but, we submit, that until the Bank renders an accounting to the Orphans' Court of the trust fund, the amounts of the respondent's (Bank trustee) claims are legally impossible of determination.

II.

Judicial Deference to State Sovereignty Required a Dismissal of the Suit.

It is respectfully submitted that the facts of the case at bar, bring it within the principles of the holdings of this Court in *Commonwealth of Pennsylvania* vs. *Williams,* 293 U. S. —, 55 S. C. R. 380 and *Casualty Company* v. *Commonwealth of Pennsylvania,* 293 U. S. —, 55 S. C. R. 386. In the former case this Court said at page 385:

> "A court of equity, which in its discretion may refuse to protect private rights when the exercise of its jurisdiction would be prejudicial to the public interest, see *United States ex rel. Greathouse* v. *Dern,* 289 U. S. 352, 359, 360, 53 S. Ct. 614, 77 L. Ed. 1250, or deny relief upon performance of a condition which will safeguard the public interest and secure substantial justice to the complainant, see *Harrisonville* v. *W. S. Dickey Clay Mfg. Co.,* 289 U. S. 334, 339, 53 S. Ct. 602, 77 L. Ed. 1208, would seem bound to stay its hand in the public interest, where it reasonably appears that the private right will not suffer. It is in the public interest that federal courts of equity should exercise their discretionary power with proper regard for the rightful independence of state governments in carrying out their domestic policy. (Citing cases). It has long been accepted practice for federal courts to relinquish their jurisdiction in favor of the state courts, where its exercise would involve control of or interference with the internal affairs of a domestic corporation of the state. (Citing cases). There are stronger reasons for adopting a like practice where the exercise of jurisdiction involves an unnecessary interference by injunction with the lawful action of state officers. *Matthews* v. *Rodgers, supra,* 284 U. S. 525, 52 S. Ct. 217, 76 L. Ed. 447."

In the *Casualty Company* case, *supra*, this Court said at page 390:

> "Although the District Court has thus acquired jurisdiction, the end sought by the litigation in the state court is the liquidation of a domestic insurance company by a state officer. In the absence of a showing that the interests of creditors and shareholders would not be adequately protected by this procedure, the case was a proper one for the District Court, in the exercise of judicial discretion, to relinquish the jurisdiction in favor of the administration by the state officer."

In the case at bar, the officer of the Orphans' Court of Allegheny County, Commonwealth Trust Company of Pittsburgh, one of the petitioners herein, is engaged in liquidating the mortgage pool subject to the orders of that court and is accountable to it, (Act of Pennsylvania 1917, P. L. 447, Sec. 46 (g) Purdon 837), in all matters arising out of its administration of the trust estate. The District Court as well as the Circuit Court of Appeals, have entered decrees, which if Commonwealth Trust Company complies with them, are now and in the future may be contrary to the orders of the Orphans' Court in liquidating the trust res, in its custody. Which court is Commonwealth Trust Company to obey?

It is the possibility of such unseemly and disastrous conflicts, which the principles of law, enunciated by this Court in the above cases, seek to avoid. An officer of a State Court, acting pursuant to the orders of that Court, should not be confronted with the possibility of contempt proceedings, in a Federal Court, when the possible contempt would arise out of obedience to the orders of the court, whose officer he is. This is not an imagined possibility. As appears at (R. 32) the Orphans' Court had prior to the proceeding in the court below from time to time ordered distributions of the trust res, but in each instance has

ordered that distribution to the respondent be suspended. The Federal Courts, in the case at bar, have both held (R. 40-41) as to the interest item "that it constitutes a valid debt of the trust and should be repaid the bank before further distributions are made to certificate holders." The Federal Courts, of course, cannot enjoin the State Court. Can they accomplish the same result by enjoining its officer?

It is submitted that the reasoning of Judge Buffington in his dissenting opinion (R. 61) is sound in law and is consistent with the deference which is due the Orphans' Court of the Commonwealth of Pennsylvania. Judge Buffington holds (R. 63):

> "In view of the facts, it would seem clear that every element of comity, consent to the Orphans' Court jurisdiction, surrender of the res, and possession thereof by the Orphans' Court, all united to constrain the Court below to dismiss the belated bill of the receiver, which in reality was not a bill to ascertain the amount of the bank's claims,—for as to the money amount thereof there was no dispute,—but was filed, as quoted above from its prayers, to oust the jurisdiction of the Orphans' Court."

III.

The Opinion of the Circuit Court of Appeals Conflicts With that of the Circuit Court of Appeals for the First Circuit.

It is respectfully submitted that respondent having submitted himself to the jurisdiction of the Orphans' Court the opinion of the majority is in direct conflict with the opinion of the Circuit Court of Appeals for the First Circuit in *Peoples Trust Company* v. *United States*, 23 F. (2nd) 381, where that court held at 383:

> "The bank commissioner, in winding up the affairs of an insolvent bank under the New Hampshire statute (P. L. c. 268), does not act merely in an executive

or administrative capacity, but as an officer of the court in the nature of a receiver, and it is in this aspect, and the fact that the complainant, before bringing this bill in the District Court, intervened in the original equity proceeding in the state court, and presented and established the validity of its claim, except as to priority, that the present case differs, so far as the question of jurisdiction is concerned, from that of *Allen* v. *United States* (C. C. A.) 285 F. 678; for in that case it appeared that the commissioner acted only in an administrative or executive capacity, and that the complainant had not presented and proved its claim before the commissioner.

It must be conceded that the District Court, as a federal court, had jurisdiction and authority to entertain the complainant's bill, the United States being a party, and that the pendency of a prior suit in the state court, involving the same subject-matter, would not operate as a bar to the present bill and justify its dismissal (*Boston & Maine R. R.* v. *Dutille* (C. C. A.) 289 F. 320), unless the original proceeding against the bank in the state court, in which the complainant intervened and proved its claim, was a proceeding in rem, or involved the exercise of possession or control over the fund in the custody and possession of the commissioner. *Kline* v. *Burke Construction Co.*, 260 U. S. 226, 229, 230, 231, 43 S. Ct. 79, 67 L. Ed. 226, 24 A. L. R. 1077; *General Outdoor Advertising Co.* v. *Williams* (C. C. A.) 12 F. (2d) 773, and cases therein cited. The reason for the exception is that, where the prior action is in rem, the effect is to draw to the court where that action is pending the possession or control, actual or potential, of the res, and the exercise by another court of jurisdiction over the same res necessarily impairs, and may defeat the jurisdiction (that has already attached) of the court in which the prior action was brought. *Kline* v. *Burke Constr. Co., supra,* at page 229 (43 S. Ct. 81); *Lion Bonding & Surety Co.* v. *Karatz,* 262 U. S. 77, 88, 89, 43 S. Ct. 480, 67 L. Ed. 871.

It must be conceded that the original bill brought in the state court against the bank, the purpose and

effect of which was the seizure and distribution of its assets among its creditors, was a proceeding in rem; and it must likewise be conceded that the complainant's intervention and proof of claim in that proceeding, and of which it thereby became a part, was a proceeding in rem, not in personam, for what the complainant sought was a judgment against the funds of the bank in the possession and control of the commissioner, under a decree of the state court. As the claimant has already prosecuted its claim in the state proceedings, the case does not fall under the doctrine of *Waterman* v. *Canal, etc., Bank,* 215 U. S. 33, 30 S. Ct. 10, 54 L. Ed. 80. The District Court, therefore, was without jurisdiction to entertain the bill."

IV.

The Opinion of the Circuit Court of Appeals On the Allowance of the Interest Item Conflicts With That of the Circuit Court of Appeals for the Eighth Circuit.

It is respectfully submitted, that on the question of allowing the recovery of interest advanced by the Bank of Pittsburgh, the opinion of the majority is in conflict with that of the Circuit Court of Appeals for the Eighth Circuit in *Trust Company* v. *Ricketts,* 75 F. (2nd) 309, where that court held at 312 *et seq.:*

"But the money advanced by the bankrupt for the taking up of interest coupons presented for payment stands in a very different situation. There was no provision in the mortgage that the mortgagee or trustee might pay such interest and have a lien therefor, there was no obligation upon it to advance interest, and the advancement of interest had no relation to the preservation of the security.

The record shows that up to July, 1931, the practice of the bankrupt had been to pay interest coupons when presented, whether funds had been furnished by borrowers or not, and that nothing was said to its custo-

mers about advancement of interest. In July, 1931, the practice was changed, and thereafter interest was not advanced or paid unless it had been paid to the bankrupt by the borrowers, and after that time the customers were notified in case funds had not been furnished by the borrowers. After July 1, 1931, the interest on mortgages on lands to which the bankrupt had taken title 'was paid if instructed by another department.' With respect to this Harriman mortgage, no bondholder knew or had any reason to know that the interest coupons which were presented for payment to the bankrupt were not paid out of funds furnished by the borrower, and the first intimation any bondholder had that the mortgage was in default, or that the bankrupt had advanced interest, was after bankruptcy. The failure of the bankrupt to notify the bondholders of default and of the failure of the mortgagor to pay interest is attributable to only one thing, and that is the desire of the bankrupt to maintain a market for the securities which it was selling. The court below said: 'With reference to the taking up of the interest coupons, we see no impropriety in the trustee taking up and holding these coupons. It may be gathered from the evidence that the trust company was engaged in the negotiation and sale of mortgage securities. The bondholders were certain of its customers. It was to the interest of the trust company that its customers should not be disturbed concerning their investments. No preference or priority is claimed for its coupons. Its claimed interests under these coupons are precisely those of the other bondholders, and there is nothing to indicate any breach of duty as against them.'

The theory of the referee and of the court below was that the taking up of the interest coupons by the bankrupt might properly be regarded as a purchase by it of the coupons. We can find no basis for such a conclusion in the evidence. There is not a scintilla of evidence that any bondholder ever intended to sell his coupons to the bankrupt. * * *

And on page 425 of 128 U. S., 9 S. Ct. 131, 134, the court said. 'In brief, Starr was engaged in floating

these bonds. They were not, as the testimony and the history of the case shows, good bonds. He was very careful to prevent anything from transpiring that would injure their credit. He cut off the coupons that were due and unpaid, so long as the bonds remained in his possession, and put up some money to redeem coupons which fell due on bonds that had been sold, so long as he was still engaged in selling other bonds. It looks very much as if Mr. Starr had dug a pit, and was anxiously keeping the pathway to it in good order. It would be inequitable, in our opinion, to allow him to bring forward these coupons as the basis of any preference over, or of even co-equal rights with, those to whom he sold his bonds; and the plaintiff, having taken these coupons when overdue, had no greater rights than he had in this respect. If the courts were to sanction such claims, the commercial securities of the world would be nullified.'

It might not be fair, upon this record to say that the bankrupt in this case had dug a pit and was anxiously keeping the pathway to it in good order, but it is very apparent that it had no desire to place any obstructions in the beaten pathway to its door. Its advancing of interest to its customers is to be attributed to a desire on its part to preserve an unimpaired market for its mortgage bonds, rather than a desire to confer a boon upon them by purchasing their interest coupons.

* * * * * * *

Our conclusion is that the interest coupons presented by the bondholders to the bankrupt, while not marked 'paid' or 'cancelled' by it, were paid and not purchased, and are not entitled to share with the bonds in the proceeds of a sale of the mortgage security. Any right which the trustee of the bankrupt may have to look to the security for reimbursemeent for interest advanced is inferior to the liens of the bondholders."

V.

The Bill in Equity Revealed on Its Face an Illegal Transaction and Hence Plaintiff Was in Court With Unclean Hands.

Respondent's Bank was trustee of various trusts (R. 26). It was also mortgagee in numerous mortgages which it owned. It sold participating interests in these mortgages to its own trust estate and in addition retained an interest in the mortgage pool (R. 28). By so doing it violated two fundamental principles of law relating to trustees,—it sold its own property to its trust estates,—*Magruder* v. *Drury*, 235 U. S. 106, and it mingled its own funds with those of its trust estates—*Schumacher* v. *Harriet*, 52 F. (2nd) 817. The participants in the mortgage pool thereby acquired a lien on the entire fund as security for the repayment of their trust investments—*Peters* v. *Bain*, 133 U. S. 670; *Trust Co.* v. *Brass Corporation*, (C. C. A. 2nd) 10 F. (2nd) 913, 914. Furthermore, the Federal Reserve Act of 1913, paragraph (k) requires that "National Banks exercising any or all of the powers enumerated in this subsection (k) shall segregate all assets held in any fiduciary capacity from the general assets of the bank * * *" (12 U. S. C. A. Par. 248, page 319). The Federal Reserve Board which has the power to exercise supervision over national banks has squarely ruled that mortgage pools, such as we have in the case at bar, are absolutely illegal. Thus in Federal Reserve Bulletin of March 1933 at page 187, the Federal Reserve Board ruled:

* * * * * * *

> "In another ruling the board considered a proposal by a national bank to deliver to its trust department all real-estate bonds and mortgages then owned or thereafter acquired by it, to be held in a revolving pool in trust for the commercial department of the bank and for the various trusts administered in the trust depart-

ment of the same bank. Trust funds were to be invested in participations in the revolving pool and participation certificates were to be issued to the various trusts for the amounts of their respective investments. The proportionate share of the entire pool over and above the amounts allotted to the various trusts was to be owned by the bank in its own right. The participating trusts were not to own or receive the income from any particular bonds and mortgages, but each trust was to own merely a participation in the pool and was to receive an income on the amount of such participation equal to the average income realized on all bonds or mortgages in the pool. Any losses incurred in the revolving pool were to be borne by all the participants in proportion to their respective participations at the time the amount of such losses was definitely ascertained. After careful consideration, the Federal Reserve Board ruled that it was unlawful and improper for a national bank to handle trust funds in this manner; because: (1) It would violate the provisions of section 11 (k) of the Federal reserve act which required national banks to 'segregate all the assets held in any fiduciary capacity from the general assets of the bank'; (2) it would violate Section VII of the Board's Regulation F which requires that, 'Securities and investments held in each trust shall be kept separate and distinct from the securities owned by the bank and separate and distinct one from another'; (3) it would violate the general rule of equity jurisprudence that a trustee must not mingle funds of various trusts with each other or with his own funds but must keep the funds of each trust separate and distinct from his own and from those of any other trust; (4) it would violate the general rule of equity jurisprudence that, in administering a trust and investing trust funds, a trustee shall not deal with himself, buy from or sell to himself, have any pecuniary interest in any transaction which he handles on behalf of a cestui que trust, or otherwise acquire any selfish interest which might interfere with the faithful dis-

charge of his duty as a fiduciary; and (5) such a method of investing trust funds is subject to important practical objections and might lead to abuses resulting in substantial losses to the trust estates. The fact that corporate fiduciaries in at least one State are permitted by State law to invest trust funds collectively in real-estate mortgage pools in this manner was brought to the Board's attention when it was considering this question; but the board held that this did not authorize national banks to engage in such practices. The ruling just described, however, was not intended to supersede the earlier ruling wherein an exception to the general rule was made solely to cover the case of balances too small to be invested separately to advantage."

It is sought to justify the creation of the mortgage pool of this respondent's Bank by resort to the Pennsylvania Statute of 1925 P. L. 152, 15 Purdon 2514. That Act permits State title insurance companies to "assign to their various trust estates participations in a general trust fund of mortgages, etc., * * *." It is to be observed at the outset, that there is nothing in the language of the above Act which authorizes a fiduciary to sell its own securities to its trust estates and as the Statute is in derogation of the well settled principle of law forbidding such transactions, only express language would justify such a construction of the statute—*Larson* v. *Bank & Trust Company,* 178 Minnesota 209; *Ulmer* v. *Fulton, Supt. of Banks,* 129 Ohio State 323.

In the second place, it will be observed that the Federal Reserve Act, Section 11 (k), 12 U. S. C. A. Par. 248, page 319, requires National Banks to segregate their assets from those of their trust estates, so that the Pennsylvania Act cannot be relied upon to justify a violation of the Federal Reserve Act, which is, of course, controlling as to National Banks.

The mortgage pool transaction of plaintiff below (respondent here) having been shown to be an illegal one, and

the respondent having mingled the trust funds entrusted to it, the plaintiff was in a Court of Equity with unclean hands and therefore not entitled to relief at the hands of the Chancellor.

The failure to raise this point in the court below is immaterial as the court was bound to notice it *sua sponte*—*Primeau* v. *Granfield* (C. C. A. 2nd) 193 Fed. 911 at 912.

VI.

The Proceeding Was Fatally Defective for Want of Indispensable Parties.

The bill of the respondent in the District Court averred (R. 4):

> "Thomas B. MacMillan, John L. Brentzell, Jane B. Wheeler and Anna L. Meyer are residents of the City of Pittsburgh and are the owners and holders of participation certificates in said fund of mortgages formerly held by The Bank of Pittsburgh National Association as Trustee and now held by the Commonwealth Trust Company of Pittsburgh, as Trustee, as aforesaid, and are joined herein as defendants as representatives of all holders of certificates issued by The Bank of Pittsburgh against said fund of mortgages, the holders of such certificates being so numerous and so widely scattered that it would be impracticable to bring them all before the Court in this proceeding, and the rights of all certificate holders being the same."

It is evident that plaintiff below, respondent here, was proceeding under Equity Rule 38, as the averments of his bill are substantially in the language of the rule.

It is respectfully submitted, that the four additional defendants are not representatives of a class and they do not represent the four hundred trust participants in the mortgage pool nor can the interests of all the trust estate participants be presumed to be the same. It should be

borne in mind that all of the participants in the mortgage pool had submitted themselves to the jurisdiction of the Orphans' Court. (R. 8). It is submitted that each trust estate is entitled to have its day in court on the question of whether its Trustee (respondent's Bank) has properly managed the affairs of the trust estate—*Ingram* vs. *Lewis* (C. C. A. 10th) 37 F. (2nd) 259 at 260; Wheeler's Assigned Estate, 287 Pa. 416 at 419, and that until this takes place through an accounting, in the Orphans' Court of Allegheny County, it will be impossible to determine the rights of the *cestuis que trustent* and Bank trustee, *inter se.* Each case will necessarily depend upon its own facts.

It is perhaps unnecessary for us to point out that the lack of indispensable parties may be raised at any time and indeed should be noticed by the court *sua sponte.* This Court sustained the first proposition in *Coiron* v. *Millaudon,* 60 U. S. (19 How.) 113 and in *United States* v. *Bean,* 253 Fed. 1 at page 6, Judge Sanborn speaking for the Circuit Court of Appeals for the Eighth Circuit held:

> " 'The established practice of all courts of equity to dismiss the plaintiff's bill,' says the Supreme Court, in *Minnesota* v. *Northern Securities Co.,* 184 U. S. 199, 235, 22 Sup. Ct. 308, 322 (46 L. Ed. 499), 'if it appears that to grant the relief prayed for would injuriously affect persons materially interested in the subject-matter who are not made parties to the said suit, is founded upon clear reasons, and may be enforced by the court sua sponte, though not raised by the pleadings or suggested by the counsel.' (Citing cases.)
>
> It is a familiar and just rule that no court may directly adjudicate a person's claim of right, unless he is actually or constructively before it. It is an established rule of practice in the conduct of suits in equity in the federal courts that every indispensable party must be brought into the court or the suit must be dismissed. And an indispensable party is one who has such an interest in the subject-matter of the contro-

versy that a final decree cannot be made without affecting his interests, or leaving the controversy in such a situation that its final determination may be inconsistent with equity and good conscience."

If, as was argued by respondent below and is held by the District Court (R. 41), respondent is a participant and *cestui que trustent* in the trust res, then the court was without jurisdiction to adjudicate the question, because it involved a determination of the rights of the participants in the trust res, as between themselves—*Byers* vs. *McCauley*, 149 U. S. 608 at 620. In *Carey* vs. *Brown*, 92 U. S. 171 at 172 this court held:

"The general rule is that in suits respecting trust property brought either by or against the trustees, the cestui que trust as well as the trustees are necessary parties."

In Matter of Straut, 126 N. Y. 201, at 212 that court held:

"If the purpose of the action had been, among other things, to determine rights as between the beneficiaries themselves, or as between the trustees and the beneficiaries, then it would have been necessary to bring them in as parties."

To the same effect is *Franz* vs. *Buder*, 11 F. (2nd) 854.

If the decree in this case is binding on all trust participants in the Bank's mortgage pool, as is the result in a true class bill, then it is respectfully urged that the various trust estates have never had their day in Court. The respondent's Bank was not a creditor of its own trust fund. It could not be in that category. It was trustee of the fund for its own benefit and that of its various trust estates. Its rights could only be established in an accounting between it and its various *cestuis que trustent*. It is impossible to grasp just how it can evade this responsibility,

by resigning and suing its successor trustee, on the theory that it has a claim against that trustee. Obviously the successor trustee is not accountable for the acts of its predecessor trustee, the Bank. If the Bank had remained as trustee it could not have filed this bill. It would have been obliged to account to the Orphans' Court in which proceeding all the beneficiaries of the trust would have had their day in Court. The theory proceeded on in the case at bar, deprives these beneficiaries of that day in Court. Certainly the decree here, is inconsistent with equity and good conscience, as to the absent beneficiaries.

It seems to us the situation in the case at bar is more likely within the provisions of Equity Rule 39 and Section 50 of the Judicial Code—28 U. S. C. Par. 111, in which event the decree here should be without prejudice to the rights of absent parties—*Ross* vs. *Texas Co.*, 23 F. (2nd) 171 at 172.

It is therefore respectfully submitted that the Writ of Certiorari should issue, as prayed for.

Respectfully submitted,

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(6660-C)